IT 01-0081-GIL 10/09/2001 PUBLIC LAW 86-272/NEXUS

General Information Letter: Nexus decision are not appropriately made in letter rulings.

October 9, 2001

Dear:

This is in response to your letter dated September 21, 2001 in which you request a letter ruling. The following is in response to your request with respect to Illinois income tax. Your request with respect to sales and use tax has been referred to the Sales Tax Division and will be addressed by a separate ruling. In addition, questions regarding Illinois franchise tax should be addressed to the Illinois Secretary of State. The nature of your letter and the information provided with respect to Illinois income tax requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be viewed on our website at www.revenue.state.il.us/information/regs/part1200.

Your letter states as follows:

> My client is requesting confirmation on whether or not it has nexus with Illinois for income/franchise tax reporting purposes. Mr. Young suggested we could include Form NUC-1 without disclosing the client's name to assist you in collecting the information you will need in making this determination.
>
> Since Form NUC-1 does not seem to solicit some information which may be relevant in your determination, I am adding additional information here. The company ships farm products from its Wisconsin location. The company does not have any employees working in Illinois, nor does it maintain an office or any inventory in Illinois. The company purchases vegetables from growers in Illinois. The contacts with the Illinois growers are by telephone or fax machine.
>
> The company sells farm products to customers in Illinois. All of the contacts with Illinois customers occur by telephone or fax machine.
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> The company does not own any trucks, nor has any employees delivering or picking up the products. All transportation of products purchased and hauled to the company's Wisconsin location, and all deliveries of products to customers in Illinois, are done by independent truck drivers. These drivers are not employees. They clearly are independent contractors. For example, they own their own trucks. They drive for their other customers in addition to this company. During the shipping season, the independent drivers call in to see if there are loads available, or sometimes the company calls them. Each driver has the full discretion whether to accept or reject a particular load. You should assume for these purposes that all drivers will be classified as independent contractors.
>
> The trucker rather than the company is responsible for unloading the shipment. The trucker gets the unloading done in a variety of ways. Sometimes the trucker does it himself or with the customer's assistance. Other times the customer insists that a local firm be hired to do it. Other times the trucker finds local free lancers who hang around the dock looking for work. The cost of hiring the unloading service is negotiable between the company and the trucker. The company tries to get the trucker to handle it out of the negotiated freight charges. But sometimes the trucker is surprised by the need to incur the expense and calls the company up looking for reimbursement on the spot, which sometimes forces the company to advance the

money in order to avoid a problem with the customer. Since the company does not hire the service, the correct analysis should be that the unloading person is not the company's agent.

The company sells some products to customers of an Illinois broker. The Illinois broker locates customers willing to buy loads from the company. The Illinois broker originally was a sole proprietor but has been incorporated for the last several years. The broker is not involved in purchasing. The broker does not inspect products which have been sold, nor collect accounts receivable from customers. The company is not aware of any post-sale activities carried on by the broker. The company pays the Illinois broker a commission measured by the quantity sold. In the year 2000, the company paid approximately $8,000 in brokerage fees to this corporate broker.

The only visits to Illinois by employees consist of one day every 3 or 4 years to visit an Illinois grower, and one day every 2 or 3 years to visit an Illinois customer. In other words, the company averages 2 days every 3 years of physical contact with Illinois. The company has reviewed its history and has found no other contacts occurring with Illinois.

Based on our understanding of nexus rules, my client would not have nexus with Illinois. Even if its activities did constitute nexus, they would seem protected under Public Law 86-272. However, if you conclude that our position is incorrect, then my client requests treatment under your voluntary disclosure program. The company has never previously filed returns with Illinois, nor ever received any inquiries from your department of revenue.

RULING

The determination whether a taxpayer has nexus with Illinois is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. However, general information regarding nexus with Illinois for income tax purposes may be provided.

I. Nexus

Constitutional Jurisdiction

The United States Constitution restricts a state's power to subject to income tax foreign corporations. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction the state seeks to tax (*Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state (*Id.*). Where any part of a foreign corporation's income is allocable to Illinois in accordance with the provisions of Article 3 of the Illinois Income Tax Act ("the IITA"; 35 ILCS 5/301-304), Illinois can demonstrate the connection or nexus necessary to subject a foreign corporation to tax. Therefore, unless protected by Public Law 86-272, a foreign corporation is liable for Illinois income tax where any portion of its income is allocated to Illinois.

IITA section 304 provides for taxable years ending on or after December 31, 2000 that the apportionment factor for a foreign corporation deriving business income from Illinois and one or more other states shall be equal its sales factor. Section 304(a)(3)(A) defines the sales factor as a fraction,

the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere. Department of Revenue Regulations section 100.3700(c)(1) states that gross receipts from sales of tangible personal property are allocable to Illinois if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale.

Your letter indicates that the taxpayer here sells farm products to purchasers in Illinois. Therefore, a portion of its net income is allocable to Illinois in accordance with the provisions of Article 3 of the IITA. Accordingly, unless protected by Public Law 86-272, the taxpayer in this case is liable for Illinois income tax.

Public Law 86-272

Public Law 86-272, 73 Stat. 555, 15 U.S.C.A. 381 (1959) states in part:

> No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either or both of the following:
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the state for approval or rejection, and , if approved, are filled by shipment or delivery from a point outside the State; and
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

In *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 227, 112 S.Ct. 2447, 2456 (1992), the Supreme Court determined that business activities constituting "solicitation of orders" include activities ancillary to requests for purchases. In addition, the Court announced that a taxpayer does not forfeit protection under P.L. 86-272 by engaging in *de minimis* activities that exceed solicitation of orders. (*Wrigley*, 505 U.S. at 231, 112 S.Ct. at 2458)

Department of Revenue Regulations ("Regulations") section 100.9720(c)(2)(C) provides that "solicitation of orders" for purposes of P.L. 86-272 means speech or conduct that explicitly or implicitly invites an order. Further, the Regulations indicate that to be ancillary to requests for purchases, an activity may not serve an independent business function apart from its connection to solicitation of orders.

Regarding *de minimis* activities under P.L. 86-272, Regulations section 100.9720(c)(2)(D) states:

> De minimis activities are those that, when taken together, establish only a trivial additional connection with this State. An activity regularly conducted within this State on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether an activity consists of a trivial or non-trivial additional connection with this State is to be measured on both a qualitative and quantitative basis. If the activity either qualitatively or quantitatively creates a non-trivial connection with this State, then the activity exceeds the protection of PL 86-272. The amount of unprotected

> activities conducted within this State relative to the amount of protected activities conducted within this State is not determinative of the issue of whether the unprotected activities are de minimis. The determination of whether an unprotected activity creates a non-trivial connection with this State is made on the basis of the taxpayer's entire business activity, not merely its activities conducted within this State. An unprotected activity that would not be de minimis if it were the only business activity of the taxpayer conducted in this State will not be de minimis merely because the taxpayer also conducts a substantial amount of protected activities within this State, nor will an unprotected activity that would be de minimis if conducted in conjunction with a substantial amount of protected activities fail to be de minimis merely because no protected activities are conducted in this State.

Accordingly, a taxpayer is not protected under P.L. 86-272 where it engages in Illinois in business activities that may not be considered solicitation, including activities ancillary thereto, and that are not *de minimis*. In *Chattanooga Glass Co. v. Strickland*, 261 S.E.2d 599, 601 (Ga. 1979), the state supreme court held that the instate purchase of raw materials was not an activity protected under P.L. 86-272. Your letter indicates that taxpayer purchases in Illinois farm products for resale. Therefore, unless such purchases may be considered *de minimis*, the taxpayer here is not protected from Illinois income tax by P.L. 86-272. In addition, your letter does not indicate whether the visits by taxpayer's employees to Illinois growers and Illinois customers are connected with solicitation of orders. Although the visits take place infrequently, your letter suggests that the visits occur on a regular and systematic basis, or pursuant to a company policy, such that a qualitative non-trivial additional connection may be found. In such case, the taxpayer is liable for Illinois income tax on all of its income allocable to Illinois in accordance with Article 3 of the IITA.

II. Voluntary Disclosure

Section 3-10(c) of the Uniform Penalty and Interest Act ("the UPIA"; 35 ILCS 735/3-10(c)) limits the period of assessment in certain cases where a taxpayer voluntarily discloses its failure to file a tax return. The section states:

> In the case of a failure to file a return required by law that is voluntarily disclosed to the Department, in accordance with regulations promulgated by the Department for receiving the voluntary disclosure, the tax may be assessed no more than 4 years after the original due date of each return required to have been filed.

The manner in which a taxpayer makes such disclosure is set forth at Regulations section 210.126. (86 Ill. Adm. Code 210.126) (copy enclosed).

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and wish to obtain a binding private letter ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of 86 Ill. Adm. Code 1200.110(b). If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)